



SENATE BILL 820: Clean Energy and Economic Security Act

2011-2012 General Assembly

Committee:	Senate Commerce	Date:	June 4, 2012
Introduced by:	Sens. Rucho, Blake, Walters	Prepared by:	Jennifer McGinnis
Analysis of:	PCS to First Edition		Staff Attorney
	S820-CSRI-44 [v. 15]		

CHANGES MADE BY PCS:

- Adds detail to a requirement included in the previous version of the PCS that the Mining and Energy Commission develop rules to require financial assurance in association with oil and gas exploration and development activities. (see G.S. 113-391(a)(5)n. on page 10).
- Adds language to clarify that the modern regulatory program to be developed for the management of oil and gas exploration and development activities in the State, including the use of horizontal drilling and hydraulic fracturing for that purpose does not include a program or rules for the regulation of oil and gas exploration and development in the waters of the Atlantic Ocean and the coastal sounds. (see new G.S. 113-391(a1) on page 11).
- Deletes provision that would have preempted local governments from enacting ordinances that would prohibit or have the effect of prohibiting oil and gas exploration and development activities and use of horizontal drilling or hydraulic fracturing for that purpose. Adds new provision to require the Mining and Energy Commission and other entities to study the issue and formulate recommendations for legislative action (see new Section 2.(k) on page 16).
- Modifies provision that requires sellers of residential real estate to disclose information concerning severance of mineral rights to potential purchasers of residential real estate. Rather than requiring disclosure through a stand-alone mandatory disclosure statement, the provision now requires inclusion of a conspicuous statement on severance of mineral rights in any real estate contract for residential transactions. (see new Section 5 on pages 26 and 27).

SUMMARY: The Proposed Committee Substitute (PCS) for Senate Bill 820 would:

- *Direct various State agencies to develop a modern regulatory program for the management of oil and gas exploration and development activities in the State, including the use of horizontal drilling and hydraulic fracturing for that purpose.*
- *Amend several statutes that currently prohibit the processes of horizontal drilling and hydraulic fracturing in order to authorize these processes; but prohibit issuance of permits for these activities until such time as the General Assembly takes legislative action to allow issuance of such permits.*
- *Enact various other provisions related to management of oil and gas exploration and development activities.*

[As introduced, this bill was identical to H1054, as introduced by Reps. Hager, Gillespie, K. Alexander, and R. Moore, which is currently in House Environment, if favorable, Finance.]

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BACKGROUND: Several years ago the North Carolina Geological Survey recognized thick sections of organic shale located in the State (Triassic Strata of the Deep River Basin – Lee and Chatham, Counties) as a potential gas resource. Modern exploration and gas production technology, such as horizontal drilling and hydraulic-fracturing, has enabled the extraction of shale gas in similar formations in other states. The use of hydraulic fracturing involves drilling a well and injecting drilling fluids under pressure to fracture the shale rock and release the gas. Drilling fluids are mostly made up of water, but also include other chemicals. The exact makeup of the drilling fluids varies from company to company.

In 2011 the General Assembly enacted legislation (S.L. 2011-276/House Bill 242) to direct the Department of Environment and Natural Resources (DENR), in conjunction with the Department of Commerce, the Department of Justice, and the Rural Advancement Foundation (RAFI-USA), to study the issue of oil and gas exploration in the State and the use of horizontal drilling and hydraulic fracturing for that purpose. Pursuant to S.L. 2011-276, DENR, in conjunction with the other entities, issued a draft report in March of 2012. After receiving public comment regarding the draft report (including public comment received at public meetings held on March 20, March 27, and April 2, 2012), DENR issued a final report on April 30, 2012 that stated "[a]fter reviewing other studies and experiences in oil and gas-producing states, DENR believes that hydraulic fracturing can be done safely as long as the right protections are in place. It will be important to have those measures in place before issuing permits for hydraulic fracturing in North Carolina's shale formations." and set forth a number of associated recommendations.

[As introduced, this bill was identical to H1054, as introduced by Reps. Hager, Gillespie, K. Alexander, R. Moore, which is currently in House Environment, if favorable, Finance.]

CURRENT LAW: Article 27 of Chapter 113 of the General Statutes governs drilling and exploration for oil and gas in the State. The General Statutes currently prohibit horizontal drilling¹ and injection of any wastes to the subsurface or groundwaters of the State by means of wells². State rules also specifically prohibit use or operation of a storage related injection well and injection of fluids for oil and gas production.

BILL ANALYSIS:

Part I. Legislative Findings and Intent

Part I of the PCS sets forth legislative findings and intent, which among other things, provide: "it is the intent of the General Assembly to authorize oil and gas exploration and development activities using the processes of horizontal drilling and hydraulic fracturing, but to prohibit the issuance of permits for these activities until such time as the General Assembly has determined that a modern regulatory program for the management of oil and gas exploration and development in the State and the use of horizontal drilling and hydraulic fracturing for that purpose has been fully established and takes legislative action to allow the issuance of permits." Part I further states that establishment of a modern regulatory program will be based on the recommendations in DENR's final report and the following principles:

- (1) Protection of public health and safety.
- (2) Protection of public and private property.
- (3) Protection and conservation of the State's air, water, and other natural resources.
- (4) Promotion of economic development and expanded employment opportunities.
- (5) Productive and efficient development of the State's oil and gas resources.

¹ G.S. 113-393

² G.S. 143-214.2(b)

Part II. Reconstitute the Mining Commission as the Mining and Energy Commission; Rename the Division of Land Resources as the Division of Energy, Mineral, and Land Resources

Part II of the PCS would reconstitute the Mining Commission as the Mining and Energy Commission, and rename DENR's Division of Land Resources as the Division of Energy, Mineral, and Land Resources. The membership of the Commission, as reconstituted under the PCS, would increase from 9 members to 14 in order to add expertise in oil and gas exploration and development. Staffing for the Commission would be provided by DENR's Division of Energy, Mineral, and Land Resources (as renamed under the PCS) and the North Carolina Geological Survey.

In addition to the matters over which the current Mining Commission has jurisdiction and authority (the Mining Act of 1971, the Control of Exploration for Uranium in North Carolina Act of 1983, among other responsibilities), the reconstituted Mining and Energy Commission (Commission) would be required to adopt rules necessary to administer the Oil and Gas Conservation Act (the "Act", Article 27 of Chapter 113 of the General Statutes), hear permit appeals and other controversies arising under the Act. Authority would be shifted from DENR to the Commission to make determinations and issue orders pursuant to the Act to: (i) regulate the spacing of wells and to establish drilling units; (ii) require the operation of wells with efficient gas-oil ratios, and to fix such ratios; (iii) limit and prorate the production of oil or gas, or both, from any pool or field for the prevention of waste; and (iv) require integration of interests.

The Commission would be required to submit quarterly written reports as to its operation, activities, programs, and progress to the Joint Legislative Commission on Energy Policy and the Environmental Review Commission.

Part III. Mining and Energy Commission and Other Regulatory Agencies to Establish Regulatory Program for the Management of Oil and Gas Exploration and Development in the State and the Use of Horizontal Drilling and Hydraulic Fracturing for that Purpose

Part III of the PCS would direct the Mining and Energy Commission and other regulatory agencies (the Environmental Management Commission (EMC), the Commission for Public Health, and the Department of Labor as appropriate to matters within their jurisdictions) to establish a regulatory program for the management of oil and gas exploration and development in the State and the use of horizontal drilling and hydraulic fracturing for that purpose. The Commission is directed to adopt rules designed to protect public health and safety; protect public and private property; protect and conserve the State's air, water, and other natural resources; promote economic development and expanded employment opportunities; and provide for the productive and efficient development of the State's oil and gas resources. The PCS sets forth a host of specific purposes for which the Commission must adopt rules, including, but not limited to, establishing standards or requirements for all of the following purposes:

- Information and data to be submitted in association with applications for permits to conduct oil and gas exploration and development activities using the processes of horizontal drilling and hydraulic fracturing,
- Collection of baseline data, including groundwater, surface water, and air quality in areas where oil and gas exploration and development activities are proposed.
- Appropriate well construction and siting standard, limits on water use, stormwater control at sites, and regulation of toxic air emissions from drilling operations (as may be appropriate relative to responsibilities of the EMC for such matters).

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- Management of wastes produced in connection with oil and gas exploration and development and use of horizontal drilling and hydraulic fracturing for that purpose (as may be appropriate relative to responsibilities of the Commission for Public Health for such matters).
- Prohibitions on use of certain chemicals and constituents in hydraulic fracturing fluids, particularly diesel fuel, and full disclosure of hydraulic fracturing chemicals and constituents to regulatory agencies, and, with the exception of those items constituting trade secrets, requirements for disclosure of hydraulic fracturing chemicals and constituents to the public.
- Installation of appropriate safety devices, and development of protocols for response to well blowouts, chemical spills, and other emergencies.
- Measures to mitigate impacts on infrastructure, including damage to roads by truck traffic and heavy equipment.
- Notice, record keeping, and reporting.
- Proper well closure, site reclamation, post-closure monitoring, and financial assurance.

The PCS would also direct the Department of Labor to develop, adopt, and enforce rules establishing health and safety standards for workers engaged in oil and gas operations in the State, including operations in which hydraulic fracturing treatments are used for that purpose.

Aside from implementation and enforcement authority over matters specifically given to the Department of Labor and the Commission, the PCS would direct DENR to enforce all other rules and all other laws relating to the conservation of oil and gas. DENR would be required to submit an annual report on its activities in this regard to the Environmental Review Commission (ERC), the Joint Legislative Commission on Energy Policy, the Senate and House of Representatives Appropriations Subcommittees on Natural and Economic Resources, and the Fiscal Research Division of the General Assembly on or before October 1 of each year.

The PCS would direct the Mining and Energy Commission, in conjunction with DENR, the Department of Transportation, the North Carolina League of Municipalities, and the North Carolina Association of County Commissioners, to identify appropriate levels of funding and potential sources for that funding, including permit fees, bonds, taxes, and impact fees, and report its findings and recommendations, including legislative proposals, to the Joint Legislative Commission on Energy Policy and the ERC or before January 1, 2013. The Mining and Energy Commission (in conjunction with the Consumer Protection Division of the North Carolina Department of Justice) would also be required to study the State's current law on the issue of integration or compulsory pooling and other states' laws on the matter, and report to the Joint Legislative Commission on Energy Policy and the ERC on or before January 1, 2013.

In addition, the PCS would direct the Mining and Energy Commission, in conjunction with the Department of Environment and Natural Resources, the League of Municipalities and the Association of County Commissioners to study the issue of local government regulation of oil and gas exploration and development activities, and the use of horizontal drilling and hydraulic fracturing for that purpose. The Commission must formulate recommendations that maintain a uniform system for the management of such activities, which allow for reasonable local regulations including required setbacks, infrastructure placement, and light and noise restrictions, that do not prohibit or have the effect of prohibiting oil and gas exploration and development activities, and the use of horizontal drilling and hydraulic fracturing for that purpose, or otherwise conflict with State law. The Commission must report its findings and recommendations, including legislative proposals, to the Joint Legislative Commission on Energy Policy and the Environmental Review Commission or before January 1, 2013.

All rules required to be adopted by the Commission, the EMC, the Commission for Public Health, and the Department of Labor would be required to be adopted no later than October 1, 2014. DENR would be tasked with coordination of the rule adoption process among the various entities. In addition, the PCS would direct that the rules be developed through an open and collaborative process that includes (i) input from scientific and technical advisory groups, (ii) consultation with the North Carolina League of Municipalities, the North Carolina Association of County Commissioners, the Division of Energy of the Department of Commerce, the Department of Transportation, the Division of Emergency Management of the Department of Public Safety, the Consumer Protection Division of the Department of Justice, the Department of Labor, the Department of Health and Human Services, the State Review of Oil and Natural Gas Environmental Regulations (STRONGER), the American Petroleum Institute (API), and the Rural Advancement Foundation (RAFI-USA), and (iii) broad public participation. The rulemaking entities and DENR would be required to identify changes needed to all existing rules and statutes necessary for the creation and implementation of a modern regulatory program.

Part IV. Authorize Horizontal Drilling and Hydraulic Fracturing; Prohibit Issuance of Permits **Pending Subsequent Legislative Action**

Part IV of the PCS would authorize the processes of horizontal drilling and hydraulic fracturing by amending two statutes that currently prohibit the practice: (1) G.S. 113-393 currently provides that drilling may not unreasonably vary from the vertical – the PCS would amend this statute to allow horizontal drilling in conjunction with hydraulic fracturing treatments; (2) G.S. 143-214.2 currently prohibits the discharge of waste to the subsurface or groundwaters of the State by means of a well – the PCS would amend this statute to allow injection of hydraulic fracturing fluid for the exploration or development of natural gas resources.

The PCS would also amend the statute governing actions required prior to drilling of wells to clarify that no oil or gas well may be drilled without a permit issued by DENR for the activity. In addition, the PCS would also prohibit the use of hydraulic fracturing treatments in conjunction with oil and gas operations or activities unless DENR has issued a permit for the activity. The PCS prohibits the issuance of permits for oil and gas exploration and development activities using the processes of horizontal drilling and hydraulic fracturing in the State until the General Assembly takes legislative action to allow the issuance of such permits, in order to allow the Mining and Energy Commission to create a modern regulatory program to govern all aspects of such activities.

Part V. Landowner and Public Protections

Part VI of the PCS would add a variety of provisions designed to add or enhance protections for landowners and the public in light of oil and gas exploration and development activities and use of horizontal drilling or hydraulic fracturing for that purpose, including:

- Modify provisions concerning entry to land for oil and gas activities.
- Establish presumption concerning oil and gas developer's liability for water contamination.
- Modify provisions requiring compensation from developer to surface owner.
- Establish requirement for developer to reclaim surface property and provide associated bond.
- Modify provisions concerning developer's indemnification of surface owner.
- Establish requirement that developers provide certain information to surface owners prior to execution of leases.
- Prohibit operation of "force majeure" clause to extend leases beyond maximum duration set forth in statute.

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- Establish amount of minimum royalty payment.
- Require agreement for use of other resources and compensation.
- Require pre-drilling testing of drinking water wells.
- Require recordation of leases.
- Require notice of assignment.
- Establish requirement for minimization of intrusion.
- Require registry of landmen.
- Require publication of information for landowners.
- Require disclosure of information concerning severance of mineral rights to potential purchasers of residential real estate.

Part VI. Create Energy Policy Oversight Commission

Part VII of the PCS would create the Joint Legislative Commission on Energy Policy, which would consist of 10 members and exercise legislative oversight over energy policy in the State.

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